

LIBRARY OF CALIFORNIA
REGIONAL LIBRARY NETWORK

LEGAL ORGANIZATIONAL MODELS

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
INTRODUCTION	1
OBJECTIVE.....	1
BACKGROUND.....	1
ASSUMPTIONS	2
DISCUSSION OF POSSIBLE LEGAL ORGANIZATIONAL STRUCTURES.....	2
Nonprofit Corporation.....	2
Introduction.....	2
Overview of Organizational Structure.....	3
Bylaws.....	7
Members and Membership.....	8
Distributions to Members	10
Directors and Management.....	10
a. Directors.....	10
b. Management	11
Director's Standard of Conduct; Liability.....	14
Meetings and Voting.....	15
Tax Exemption.....	15
Reporting Requirements to Governmental Agencies.....	17
Joint Powers Agency.....	17
Comparison of Organizational Models; Other Models.....	19
Timetable for Implementation.....	20
CONCLUSION.....	20

RECOMMENDATION.....	21
---------------------	----

EXECUTIVE SUMMARY

With the adoption of the Library of California Act (the “Act”) and the pending finalization of the Regulations to implement the Act, regional library network planning groups need to prepare and submit their plans to the Library of California Board (“state board”) for approval. The plans are to include, among other things, an organizational structure and bylaws. While the Act identifies certain necessary components of the network’s structure and governance, it does not specify the type of legal organization of the network. This discussion paper examines the legal aspects of possible organizational structures for the networks.

One possible organizational model is that of a tax-exempt, nonprofit public benefit corporation. The corporation would be formed under California Nonprofit Public Benefit Law for public purposes and would also be exempt from federal and state income taxation. By forming a corporation and gaining tax-exempt status, the network will need to comply with various corporate and tax law formalities. This paper describes the framework of applicable corporate and tax law in light of the Act and the Regulations as well as earlier discussions contained in The Library of California Report.

The nonprofit corporation’s bylaws would contain the procedures for the governance and operation of the corporation’s conduct and activities. In light of the Act, particular attention will need to be paid to provisions dealing with the composition of the membership, membership policies, the role of the state board, and the relationship of the regional library council to the board in matters of governance of the corporation. An important component of this structure is the fact that a public benefit corporation must dedicate its assets to public or charitable purposes and may not distribute its assets to members. In addition, tax law relating to exempt organizations will in some ways limit what the corporation can do. Notwithstanding the need to operate the corporation within the parameters defined by applicable corporate and tax law and what may appear to be the complexity of those laws, given the public focus of the regional library network and the scope of its anticipated activities, the tax-exempt, nonprofit corporation model appears to be the most appropriate, if not the only viable, organizational structure for the network.

The other organizational structure that is examined is that of a joint powers agency. These agencies are formed by public agencies to jointly exercise common powers. While joint powers agencies provide for a very flexible and efficient form of organization, without additional State legislative authorization, they will not fulfill the requirements of the Act for regional networks. This is because, under current state law, private organizations and institutions are not eligible to join joint powers agencies. Since the Act mandates a network that can include private institutions and privately owned libraries as members of the regional networks, the joint powers agency structure is not currently a possible form of organization. Should the planning groups feel that a

joint powers agency is a more desirable form of entity for the regional networks, it would be possible to seek authorization from the State Legislature through amendment of state law. However, legislative action would likely delay establishment and implementation of the regional networks.

At this point, the recommended organizational structure is that of a tax-exempt, nonprofit public benefit corporation. This form of organization, while subject to corporate and tax law requirements, appears to be the most appropriate organizational structure for the networks absent seeking special legislative authorization permitting nonpublic entities to join a joint powers agency for regional library network purposes.

LIBRARY OF CALIFORNIA
REGIONAL LIBRARY NETWORK
LEGAL ORGANIZATIONAL MODELS

INTRODUCTION

For decades, California's public libraries have come together to cooperate and collaborate to improve services to those other than their primary clientele. Under the California Library Services Act ("CLSA"),¹ the state currently provides support to resource-sharing organizations for public libraries through 15 CLSA public library systems. With the adoption of the Library of California Act ("Act"),² the resource-sharing, cooperation and collaboration among public libraries is to be extended to California libraries of all types – academic, school, special, as well as public libraries – creating a multitype library network which will permit greater access by all Californians to the resources of all libraries in the state.

OBJECTIVE

To present possible legal alternative organizational structures for the regional library networks under the Act for consideration by the network planning groups.

BACKGROUND

Under the Act, the regional library network is a not-for-profit, cooperative organization established by the Library of California Board ("state board") composed of libraries within the public library jurisdictions or institutions that choose to become members and agree to share resources and services with, or to provide resources and services to, or both, other members of the regional library network.³

The Act requires that each regional library network submit a plan to the state board for approval. The plan is to include:

- a. An organizational structure;
- b. Bylaws;
- c. Membership policies;
- d. A long-range plan;
- e. The endorsement of charter members; and
- f. Geographical contiguity.⁴

¹ Education ("Ed.") Code §§18700 *et seq.*

² Ed. Code §§18800 *et seq.*

³ Ed. Code §18810(s).

⁴ Ed. Code §18840.

The Act provides some guidance regarding the organizational structure of a network but does not specify or even suggest what legal form of organization the network should take. Instead, that decision is left to each network planning group to propose. The Act does identify who may be a member of the network and prescribes that each network is to have a regional network council and a representative board selected by the members of the council. Each member of the council and the board is to have one vote.

In 1996, the California Library Networking Task Force of the California State Library published The Library of California Report (the "Report").⁵ The Report represented the culmination of seven years of planning sessions by the library community regarding the formation of a statewide multitype library network. The Report was a precursor to the Act and provides valuable insight into the goals and suggestions for building a viable statewide network.

ASSUMPTIONS

Any potential organizational structures for the regional library networks must be able to comply with the requirements of the Act and the Regulations.⁶ In addition, the following characteristics have been identified as desired components of an organizational structure:

- a. Flexibility in management and operation;
- b. Capacity to enter into contracts, own property and exercise other legal rights;
- c. Limitations on managers' and members' liability; and
- d. Exemption from federal and state income tax.

DISCUSSION OF POSSIBLE LEGAL ORGANIZATIONAL STRUCTURES

Nonprofit Corporation

Introduction

One viable form of legal organization for a regional library network is the nonprofit corporation. Nonprofit corporations can have members, have a board of directors and officers, enter into contracts, own assets, hire employees and generally conduct their activities and affairs similar to for-profit corporations. Articles of incorporation are filed with the California Secretary of State to create the legal entity, and bylaws are adopted to serve as the working rules for the corporation. One of the main differences between a for-profit and a nonprofit corporation, however, is that a nonprofit corporation is limited in

⁵ The Library of California Report, 1996, California Library Networking Task Force/California State Library.

⁶ At the time of the preparation of this discussion paper, final regulations had not yet been issued. References to the Regulations in this paper are to modified Proposed Regulations made available pursuant to a Notice of Modification to Text of Proposed Regulations dated September 15, 1999.

what it may do with the profits of its operations. Unlike a for-profit corporation that distributes its profits to its shareholders, a nonprofit corporation is not permitted to distribute its profits to those who control it.

In order for a nonprofit corporation to be exempt from federal and state income taxation, it must take the additional step of applying for and then receiving tax-exempt status. Simply because an entity is a nonprofit corporation, it does not mean it is automatically tax-exempt. When a nonprofit corporation is referred to as being tax-exempt, it commonly means that it has met certain organizational and operational criteria so as to be exempt from federal and state income taxation.⁷ The Internal Revenue Service recognizes a number of different types of nonprofit corporations as tax-exempt depending on their purposes. One of the most common types of tax-exempt nonprofit corporations is the charitable organization, which encompasses organizations formed for charitable, educational, scientific, religious and other similar purposes. These organizations are often referred to as “501(c)(3)” organizations because they are exempt from federal income tax by reason of section 501(c)(3) of the Internal Revenue Code (“IRC”).⁸ The tax treatment of 501(c)(3) organizations differs from that of other nonprofits, most notably in that contributions to these organizations are generally deductible by individuals and corporate taxpayers.

The regional library network is the vehicle by which the state board will be able to implement some of the provisions of the Act. Because of the public purpose of the regional library network, the type of nonprofit corporation to be formed would be a public benefit corporation. Public benefit corporations are formed for public or charitable purposes and are governed by California Nonprofit Public Benefit Corporation Law (“Nonprofit Law”).⁹ Tax-exempt organizations must also comply with applicable provisions of the IRC and state tax law. The following discussion describes the organizational structure, management aspects and tax matters that govern tax-exempt, nonprofit public benefit corporations.

Overview of Organizational Structure

The relationship among participants in a nonprofit corporation can be viewed in a hierarchical manner. A nonprofit corporation may, but is not required to, have members. Under Nonprofit Law, if there are members, the members have the ultimate right to approve or authorize certain significant corporate actions, including the right to elect the board of directors.¹⁰ The board of directors directs the activities and affairs of the corporation and exercises its corporate powers. The board oversees board committees, officers and others who have been delegated management duties or

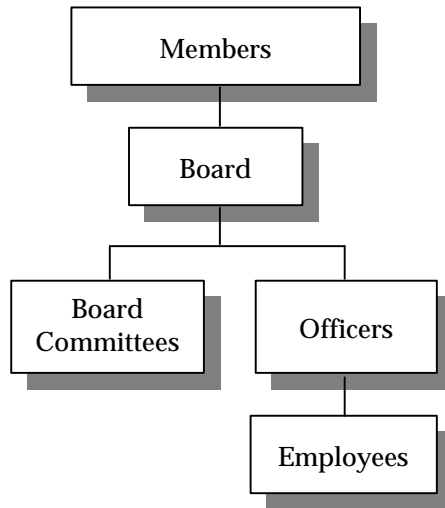
⁷ Exemptions from other federal and state taxes (such as excise, employment, sales, use and property taxes) may also be obtained, but is beyond the scope of the discussion here.

⁸ The comparable state tax provision is Revenue and Taxation (“Rev. & Tax”) Code §23701d.

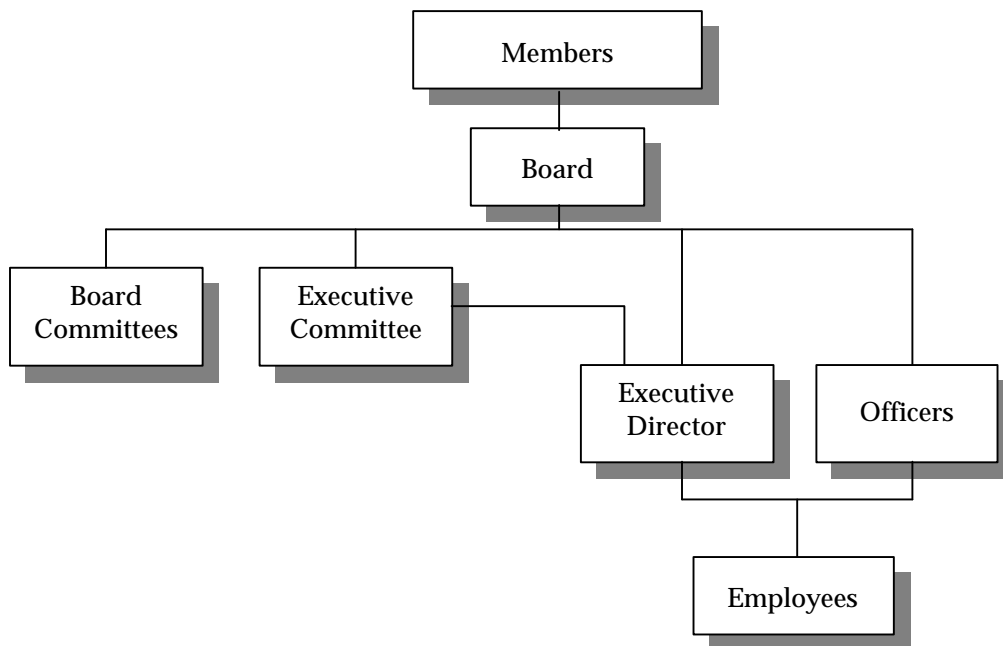
⁹ Corporations (“Corp.”) Code §§5110 *et seq.*

¹⁰ Other member rights include the right to vote for the disposition of all or substantially all of the corporation’s assets, merger, dissolution, and changes to the articles or bylaws. Corp. Code §5056.

activities. The officers oversee the corporation's employees, if any. A basic structural model would be:



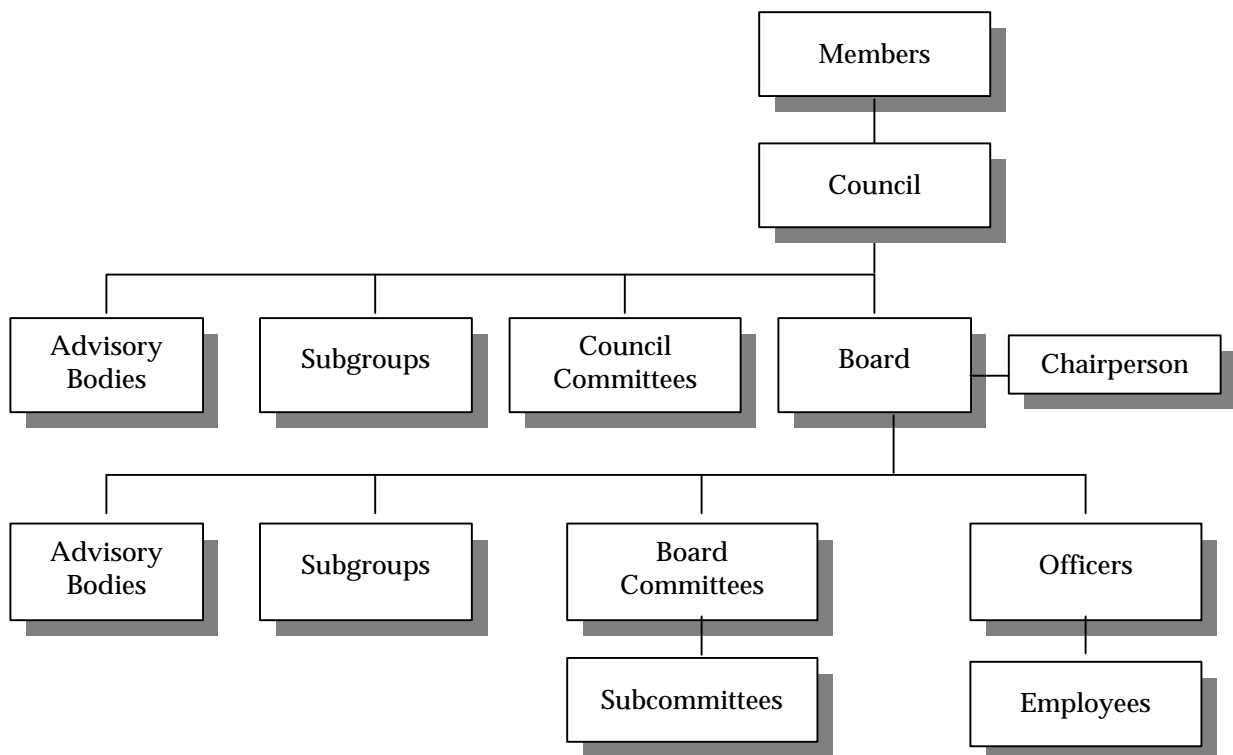
A more developed model would incorporate an executive committee and an executive director:¹¹



The Act describes the regional library network as having a regional library council in which: (a) every eligible public library jurisdiction is designated as a member and its library director or designee is its representative on the council;

¹¹ An executive committee is usually composed of a specified number of board members which has much or all of the power of the board between board meetings but which cannot modify any action taken by the board. An executive director is usually a salaried officer who devotes full time to work as an administrative officer of the organization. Some duties otherwise performed by the president may be split off and given to the executive director.

(b) every eligible institution of which one or more participating libraries is designated as a member and the institution's designated representative is on the council; and
(c) one library user from each type of library is on the council.¹² The council then elects from its membership a representative board to carry out the council's policies.¹³ There is to be a chairperson and there may be subgroups, committees and advisory bodies as deemed necessary.¹⁴ Further, under Nonprofit Law, there must at least be a president (unless there is a chairman of the board), a secretary and a chief financial officer.¹⁵ The officers are usually chosen by the board and serve at the pleasure of the board unless other provisions in the corporation's articles or bylaws are made. Thus, the structure of the regional library network can be modeled in a way similar to that of a typical nonprofit corporation:



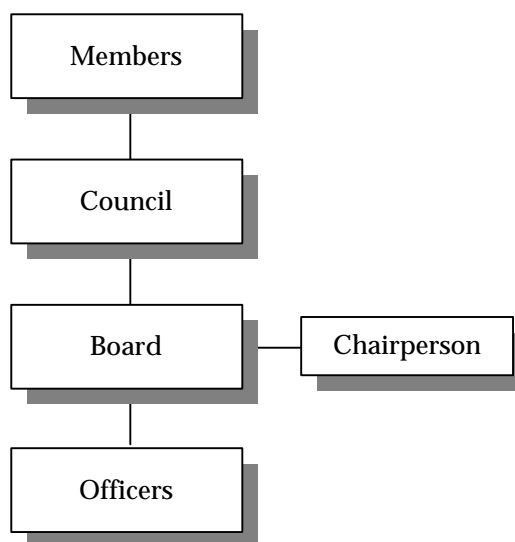
¹² Ed. Code §18841(a).

¹³ Ed. Code §18841(b).

¹⁴ Title 5, Code of Regulations ("5 Code of Regs.") §20323. The Regulations do not specify whether the chairperson is to preside over the council or over the board. Typically a chairperson is elected at the board level to preside over board and member meetings. Regarding subgroups, section 18859 of the Education Code refers to participation in programs by the Statewide Resources Library Group.

¹⁵ Corp. Code §5213.

For networks which may not require as elaborate an organizational structure or would prefer to start out with just the essential components required by the Act and Nonprofit Law, the structure would be as follows:



Under this basic structure, the officers of the corporation would be the chairperson, a secretary and a chief financial officer. While a person may hold more than one office, neither the secretary nor the chief financial officer may concurrently serve as the chairperson (or president, if there is one).¹⁶

Bylaws

Bylaws provide the operating rules for a corporation similar to the way bylaws are used by those CLSA public library systems operating under a Joint Exercise of Powers Agreement. Bylaws contain procedures for the governance and operation of the corporation's conduct and activities where Nonprofit Law or other law is silent or where there is a desire to alter specific default rules that would otherwise control absent a contrary provision in the bylaws. They also contain many standard statutory provisions for easy reference by the board, officers, members and other interested persons. Bylaws typically set forth the number of directors for the corporation; time, place and method of calling meetings of members, directors and committees; the duties and powers of directors; the method of election and qualification of directors and their terms; the manner of appointment, duties and tenure of officers; requirements of reports to members; rules for admitting and terminating members; and special requirements for the percentage of votes of members and directors needed to take certain actions and to constitute a quorum.

The Act specifically sets forth certain duties that are to be the responsibility of the regional library council. Some of these duties are ordinarily the responsibility of

¹⁶ Corp. Code §5213(a).

the board of directors of a corporation. The following discussion of members, directors and management will describe in greater detail the provisions of the bylaws that will be required for compliance with the Act since the Act provides for a more active role by the members of the regional library council in the conduct of the activities and affairs of the corporation. Membership policies, which are subject to the approval of the state board,¹⁷ will also need to be set forth in the bylaws. Further, the bylaws, and possibly the articles, will also need to provide for the role of the state board in certain aspects of the network.

Members and Membership

Membership in the regional library network will exist on three levels. There is membership in the network itself, membership on the regional library council and membership on the representative board of the network.

Regarding the network, the Act provides that each public library jurisdiction, school district, university or college and institution or corporation, or agency or branch thereof, may become a member of a regional library network.¹⁸ All of these types of eligible libraries appear to be eligible to become members of a nonprofit corporation. Geographic boundaries determine which regional library network a public library jurisdiction or institution and its participating libraries may join, with exceptions being approved by the state board.¹⁹ Those eligible libraries joining the network at the time of its formation are to be known as charter members,²⁰ and each regional library network is responsible for assuring member compliance with the Regulations for continuation of membership through membership policies and procedures.²¹

The council is comprised of the (a) library director or designee representative of every eligible public library jurisdiction, (b) a designated representative from among directors of participating libraries and chief library coordinators of every eligible institution of which one or more libraries is a participating library, and (c) one library

¹⁷ Under the Act, the state board has the right to approve various aspects of a regional library network's plan in order for the network to be eligible for funds. Ed. Code §18840. It is not clear from the Act or the Regulations, however, whether the state board is to have ongoing oversight of these matters, particularly whether state board approval would be required for any or all amendments to a network's bylaws or membership policies.

¹⁸ Ed. Code §18830(a).

¹⁹ Ed. Code §18831(a).

²⁰ The Act only requires there to be at least two types of libraries as charter members. Ed. Code §18840(e).

²¹ 5 Code of Regs. §20312(b).

user from each type of member library.²² Each member of the council will have one vote.²³

Members of the network's board are to be elected from members of the council from the same type of library. Neither the Act nor the Regulations identifies the number of members to serve on the board although the Act does require that the board be comprised of at least one representative from each type of member library and at least one library user.²⁴

Under the Act, the state board has a role in defining the membership of a regional library network. Not only does the state board approve the geographic boundaries of a regional library network, but it also defines certain aspects of who may be in a network. Specifically, the state board is to:

- a. Certify affiliations of institutions or public library jurisdictions joining the regional library network serving its geographic area; approve exceptions to the geographic boundary requirements; or allow all participating libraries of a single institution or public library jurisdiction to be served by a single regional library network;²⁵
- b. Approve changes of affiliation for any institution or public library jurisdiction presently or previously a member of a regional library network that wishes to join another network where the new network does not serve the geographic area in which the institution or jurisdiction is located;²⁶
- c. Administer an appeals process for membership eligibility in a regional library network;²⁷ and
- d. Approve the consolidation, realignment or division of regional library networks.²⁸

²² Ed. Code §18841(a). Note that all members of the council are participating libraries, but not all participating libraries qualify for membership on the council. For example, if a public library jurisdiction has two or more libraries, the public library jurisdiction would be a member and have a representative on the council, but the individual libraries would not also qualify for membership on the council.

²³ *Ibid.*

²⁴ Ed. Code §18841(b).

²⁵ 5 Code of Regs. §20314. Also, if participating libraries of an institution or public library jurisdiction are located in geographic areas served by different networks, the institution or public library jurisdiction may become a member of each network where there is a participating library (state-supported services would be received from only one network, however).

²⁶ 5 Code of Regs. §20316.

²⁷ Ed. Code §18821(h) and 5 Code of Regs. §20317.

²⁸ 5 Code of Regs. §§20319, 20320, 20321.

These matters will need to be addressed in documents between the state board and the regional library network as well as in the network's bylaws.

Other membership issues include the membership of subgroups, advisory bodies and committees. Further, membership policies established by the network will not only need to include proposed initial eligibility requirements and withdrawal provisions (with the approval of the state board), but also requirements for continuing eligibility, transfers and termination of memberships, and effect of a termination of membership.

Distributions to Members

One of the unique characteristics of public benefit corporations is that no distributions of corporate assets may be made to its members at any time.²⁹ This does not mean that network participating libraries cannot receive state-supported services from the network or receive state funds for services delivered. Rather, unlike shareholders in a for-profit corporation who receive distributions of company profits in the form of dividends, members of nonprofit public benefit corporations are prohibited from receiving such distributions.

Directors and Management

a. Directors

The network board is to be comprised of at least one library representative from each type of member library and at least one library user. Thus, assuming that a network has members from each of the four library types, the minimum size would be five. The ultimate size, however, is left to the network to determine. Recognizing that a network's council membership can easily be in the hundreds, a council would be wise to limit the size of the board to a small, workable number.

Under Nonprofit Law, the size of the board may be a fixed number or a number within a statement minimum and maximum with the exact number fixed by approval of the board or the members.³⁰ It is important to note that once members have been admitted, however, a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may only be adopted by approval of the members.³¹ In the Report, it was suggested that the council and the board could be combined, but only until membership on the council reached thirty.³² The size of the board will likely depend on the particular circumstances of a region. Large boards can be cumbersome and may require the use of executive and other committees to be effective. Small boards may not provide adequate representation of the members if there are diverse groups or

²⁹ Corp. Code §5410.

³⁰ Corp. Code §5151(a).

³¹ Corp. Code §5151(b).

³² The Report at page 64.

interests. It may also be more difficult to satisfy quorum requirements with a large board.³³

In addition to determining the size of the board, the network planning groups will need to determine how board seats will be allocated and how many board seats will be set aside for library users. Some potential allocation formulas for board seats could include allocation based on a pro rata basis depending on the number of a particular type of library in the network, total library volumes of the same type of library or geographic clusters by library type. The Act requires that the board include at least one representative from each type of library elected by representatives of that type of library and one library user.³⁴ However, there is no requirement that all board members be elected only by representatives of the particular board member's type of library.

Another aspect of the board for the planning groups to consider is the length of board terms and whether they should be staggered. Directors may be elected for terms up to three years although the articles of incorporation or bylaws may provide that some or all of the directors may hold office by virtue of designation or selection rather than by election by members.³⁵ The three-year limitation on the length of a particular term does not preclude election to two or more consecutive terms of office. If board terms are longer than one year, the terms may be staggered.³⁶ Multi-year staggered terms are often used where there may be a greater need for continuity in management such that staggered terms help to lessen the effect of a complete change of management when board terms expire.

Those elected to sit on the board will be members of the council. In electing board members, the council will need to keep in mind that under Nonprofit Law, no more than 49 percent of the directors of a public benefit corporation may be "interested persons."³⁷ An interested person includes: (a) any person compensated for services rendered to the corporation (other than as a director) during the previous 12 months; and (b) brothers, sisters, spouses, parents, descendants and in-laws of interested persons.³⁸ The focus of the inquiry should be on the services that the director or a close relative has rendered or contemplates rendering to the corporation.

b. Management

In the typical nonprofit corporation, the board of directors serves as the governing body of the corporation conducting the activities and affairs of the

³³ A quorum is usually a majority of the authorized number of directors. The articles or bylaws may alter this rule but they cannot provide for a quorum that is less than one-fifth of the total number of authorized directors. Corp. Code §5211(a).

³⁴ Ed. Code §18841(b).

³⁵ Corp. Code §5220(a), (d).

³⁶ Corp. Code §5220(a).

³⁷ Corp. Code §5227(a).

³⁸ Corp. Code §5227(b).

corporation and directing the exercise of all corporate powers. The board may delegate management of activities to committees, officers or other persons, but unless there are other provisions in the corporation's articles or bylaws, it is ultimately the board that manages and exercises the powers of the corporation.³⁹

It is possible to organize the corporation so that the regional library council has a more active role than the board in conducting the activities and affairs of the corporation and exercising its corporate powers. The Act specifies that the duties of the regional network council include "overall administrative responsibility for the network, adopting an annual plan of service, assuring the appropriate expenditure of funds, and submitting annual budget proposals to the state board for implementation."⁴⁰ The bylaws of the corporation will need to specify which of the following actions (in addition to those identified in the Act) will be exercised by the council instead of the board:⁴¹

1. Adopting, amending or repealing bylaws;
2. Amending the articles;
3. Filing vacancies on the board and removing directors in some instances;
4. Electing officers;
5. Employing an executive director, if applicable;
6. Appointing and assigning duties to committees of the board;
7. Adopting the annual budget;
8. Planning the year's activities;
9. Adopting corporate policies and long-term plans;
10. Investing corporate funds;
11. Complying with governmental reporting requirements and taxation laws;
12. Issuing reports and financial statement to members and acting on members' requests for inspection of records;
13. Calling and fixing special membership meetings;
14. Deciding to seek member approval by written ballot and preparing, distributing, tabulating and reporting the ballot results;
15. Bringing or defending legal actions on behalf of the corporation;
16. Designating the corporate depository and authorized signatories;
17. Approving corporate borrowing or loans;
18. Approving indemnification of corporate directors, officers and other agents;
19. Approving liens on corporate property to secure payment or performance of contracts or obligations;
20. Approving the sale, lease, conveyance, exchange, transfer or other disposition of corporate assets; and

³⁹ Corp. Code §5210.

⁴⁰ Ed. Code §18841(a).

⁴¹ Some of the actions, such as item 21 below, may be reserved to the state board.

21. Approving mergers, reorganizations and dissolutions.⁴²

The Report suggests that the following matters be the responsibility of the council, some of which are specifically addressed in the Act⁴³:

1. Adopting the annual service program;
2. Adopting the annual operating budget;
3. Adopting the mission, goals and long-range service plan;
4. Adopting and amending the bylaws;
5. Determining membership fees;
6. Defining network performance standards and evaluative mechanisms;
7. Evaluating network performance;
8. Determining membership policies, including the establishment of an appeals process and a waiver process;
9. Approving new members; and
10. Lobbying/advocating for the network.⁴⁴

Further, the Report suggested the following duties could be delegated from the board to the council (and that the council could delegate its roles and responsibilities to the board), while the Act merely charges the board with carrying out the policies of the regional network council:⁴⁵

1. Employ staff;
2. Administer the implementation of the annual service program;
3. Receive and disburse all income;
4. Contract;
5. Oversee day-to-day operations; and
6. Designate a liaison to the state network organization (if it exists) and/or to other networks.⁴⁶

In addition to defining the role of the council and the board, the bylaws will need to describe the officers of the corporation. The regional library network will have a chairperson.⁴⁷ The role of and duties of the chairperson, while not defined in the Act or the Regulations, would appear to be consistent with a chairperson's role in a corporation. The chairperson would preside at all meetings of the council and the

⁴² Advising California Nonprofit Corporations, 2nd Ed., Continuing Education of the Bar, §8.2 (1998).

⁴³ Adopting an annual plan of service (item 1) is a duty of the council (Ed. Code §1884(a)); the long-range service plan (item 3) is to be submitted to the state board for approval (Ed. Code §18840) as are membership policies (item 8), however, the appeals process is to be handled by the state board (Ed. Code §18821(h)); membership fees (item 5) may not be assessed for access to service delivered by the state funds (Ed. Code §18830(c)).

⁴⁴ The Report at page 64.

⁴⁵ Ed. Code §18841(b).

⁴⁶ The Report at page 64.

⁴⁷ 5 Code of Regs. §20323(a).

board and exercise and perform such other powers and duties and may be, from time to time, assigned to the chairperson by the council and the board.

As mentioned above, under Nonprofit Law, the corporation must also have a secretary and chief financial officer, and may have a president, but is not required to since it will have a chairperson. The president, if there is such an officer, would be subject to any supervisory powers given by the council and board to the chairperson. The president typically has general supervision, direction and control of the activities and affairs of the corporation subject to the control of the board. The secretary and chief financial officer have those duties typically assigned to persons holding those offices. For example, the secretary keeps the book of minutes of the proceedings of the board, committees and other bodies, sends notices of all meetings required by the bylaws and has such powers and performs such other duties as may be assigned by the board or the bylaws. The chief financial officer keeps and maintains adequate and accurate records of accounts, deposits monies, reimburses funds as directed, reports on the financial condition of the corporation and has such powers and performs such other duties as may be assigned by the board or the bylaws.

Typically, the officers are chosen by the board on an annual basis and serve at the pleasure of the board subject to the rights, if any, an officer may have pursuant to an employment contract. The articles or bylaws of the corporation may provide for a different manner of selection of the officers; however, if any officer is elected by the members of the corporation, the officer's term of office may not exceed three years.⁴⁸

Director's Standard of Conduct; Liability

Nonprofit Law sets forth a standard of conduct for directors of nonprofit public benefit corporations. Generally, a director is required to perform the duties of director in good faith, in a manner the director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. In doing so, a director may rely on reliable and competent officers, employees, outside experts and committees of directors.⁴⁹ With the exception of liability for "self-dealing transactions,"⁵⁰ a director who performs his or her duties in accordance with the standard set forth will not have personal liability based upon any alleged failure to discharge his or her duties as a director.⁵¹

Under Nonprofit Law, the corporation will have the power to indemnify directors and officers and all other agents of the corporation for any threatened, pending or completed action or proceeding, whether civil, criminal, administrative or

⁴⁸ Corp. Code §5213.

⁴⁹ Corp. Code §5231(b).

⁵⁰ Generally, any transaction to which the corporation is a party and in which a director has a material financial interest. Corp. Code §5233.

⁵¹ Corp. Code §5231(c).

investigative.⁵² Considerations regarding the availability of indemnification include the nature of the proceeding, its outcome, the person's conduct at issue and approval of the indemnification by the corporation, the California Attorney General or appropriate court. Indemnification is usually authorized only after it has been determined that the person's conduct satisfied the minimum standards of care. For third-party actions, it must be found that the person acted in good faith and in a manner he or she reasonably believed to be in the best interests of the corporation. In a criminal proceeding, the person must also have had no reasonable cause to believe that his or her conduct was unlawful. If an action is brought on behalf of the corporation, the standard is the same as a third party action with the additional requirement that the person used such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use in similar circumstances.

Meetings and Voting

Regular meetings must be held by the council and the board.⁵³ These meetings are to be open and accessible to the public in compliance with the Open Meetings Act.⁵⁴ While compliance with the Open Meetings Act will add a layer of complexity to the conduct of the meetings, the rules regarding meetings (e.g., notice, agendas) and voting are fairly straightforward.⁵⁵ The network planning members will want to consider what quorum requirements there will be for meetings. Normally, one-third of the voting power, represented in person or by proxy, constitutes a quorum at a meeting of members. However, the bylaws can authorize a quorum of less than one-third.⁵⁶ The planning members may also want to consider whether to require a supermajority or unanimous vote for certain corporate actions.⁵⁷ The bylaws may require such a vote (either by the members or any class, unit or group of members) for any corporate action except a vote to remove directors for cause⁵⁸ and a vote to elect to voluntarily wind up and dissolve the corporation.⁵⁹

Tax Exemption

⁵² Corp. Code §5238.

⁵³ 5 Code of Regs. §20323(b).

⁵⁴ 5 Code of Regs. § 20303(b); (See Government ("Gov.") Code §§54950 *et seq.* The proposed Regulations require meetings to be "open and accessible" as required by the Open Meetings Act. Depending on the way the regional networks are organized, they may or may not be subject to all statutory requirements of the Open Meetings Act. (See Gov. Code §65962(c).) The exact scope of required compliance with the Open Meetings Act will need to be determined by each regional network and the state board as the exact structure of each network is developed.

⁵⁵ There are some additional requirements regarding the election of directors which must be met if a corporation has more than 500 members. Corp. Code §§5520 *et seq.*

⁵⁶ Nonprofit Law requires that the only matters that may be voted upon at a meeting attended by less than one-third are matters identified in the meeting notice. This will not be an issue for a network since in complying with the Open Meetings Act, the agendas will contain a brief description of each item to be discussed. Corp. Code §5512(b); Gov. Code §54954.2(a).

⁵⁷ Corp. Code §5151(e).

⁵⁸ Corp. Code §5222(a).

⁵⁹ Corp. Code §6610.

Nonprofit corporations must apply to the Internal Revenue Service and the California Franchise Tax Board for exemption from federal and state income tax. To qualify for exemption as a 501(c)(3) organization, the corporation must: (a) have a public or charitable purpose; (b) dedicate its assets on dissolution to a similarly exempt organization; (c) not permit any part of the net earnings of the corporation to inure to the benefit of any private shareholder or individual; (d) not be organized or operated for the benefit of private interests or for persons controlled by such private interests; (e) not participate to any extent in a political campaign for or against any candidate for public office; and (f) not attempt to influence legislation as a substantial part of its activities unless an election is made to come under provisions allowing some lobbying activities.⁶⁰ Donors to the organization may receive charitable tax deductions for their contributions.⁶¹

Once a corporation is granted tax-exempt status, it will need to comply with various ongoing regulatory requirements. To maintain tax-exempt status, the organization must remain organized and operated exclusively⁶² for its public purposes; its net earnings must not benefit private persons to more than an insubstantial degree or inure to the benefit of any insider; and it must comply with the restrictions on engaging in political campaigning or lobbying. Certain activities may result in an imposition of tax if, for example, the organization receives net income from a regularly conducted trade or business that is unrelated to the purpose or functions that qualify it for tax exemption.⁶³

The process described above relates directly to an organization applying for recognition of exempt status on its own. There are two other variations on the process for obtaining tax-exempt status that should be considered. The first involves forming the corporation as a supporting organization. A supporting organization is one organized exclusively for the benefit of, to perform the functions of, or to carry out the purposes of, one or more specified publicly supported charitable organizations.⁶⁴ The supporting organization is a separate entity from the entity it supports and has its own board.

In this case, the network could have a relationship with the state board in which the network is considered to be “operated in connection with”⁶⁵ the state board. Generally, this requires that the network be responsive to and significantly involved in the operations of the state board.⁶⁶ The network would still have to apply for tax-exempt status, but as a supporting organization, it would not need to monitor the

⁶⁰ IRC §501(c)(3); Rev. & Tax. Code §§214, 23701d.

⁶¹ IRC §170.

⁶² “Exclusively” has been interpreted to mean “primarily.” No more than an “insubstantial” part of an organization’s activities may be other than to further an exempt purpose.

⁶³ IRC §513; Rev. & Tax. Code §23731(a).

⁶⁴ IRC §509(a)(3)(A).

⁶⁵ Treas. Reg. §§1.509(a)-4(a)(3), 1.509(a)-4(f)(2).

⁶⁶ Treas. Reg. §1.509(a)-4(f)(4).

sources of its financial support on a continuing basis as other public charities are required to do.⁶⁷

Another basis upon which to gain exempt status is to seek what is commonly referred to as a group exemption.⁶⁸ If an organization is affiliated with and subject to the general supervision or control of a central organization, it may be recognized as a tax-exempt organization solely by reason of its relationship with the parent organization. This is somewhat different from the supporting organization in that tax-exempt status acquired through a group exemption relieves the affiliate organization from filing its own application for recognition of tax exemption. In this case, where the general requirements for recognition of tax-exempt status by the networks are met and each of the networks has an organizing document, a group exemption letter would be issued to the state board.

While the group exemption eliminates the need for each organization to seek tax-exempt status, there are some disadvantages. Members of the group would not individually possess determination letters as to their tax-exempt status and this may cause difficulty with donors and grantors. Also, if a member of the group is found liable for damages, the existence of the group may be used to assert liability on the part of the central organization.

Both the issues of forming a network as a supporting organization or seeking a group exemption letter require further evaluation and discussion of the benefits to the state board and various network organizations.

Reporting Requirements to Governmental Agencies

Tax-exempt, nonprofit public benefit corporations are subject to various ongoing federal, state and local reporting requirements. At the federal level, income and employment tax returns may need to be filed with the IRS. At the state level, there are reports required to be filed with the Secretary of State and the Attorney General and there may be filings required with the Franchise Tax Board and other state agencies. At the local level, there may also be filings for property and sales tax matters. See Appendix A for a list of some of these reporting and filing requirements.

Joint Powers Agency

California law authorizes two or more public agencies to enter into agreements to jointly exercise any power common to the public agencies involved.⁶⁹ These agreements are commonly known as “joint exercise of powers agreements” or “joint powers agreements” and are in wide use in California. Under the authorizing statute, a

⁶⁷ Generally, in order to maintain tax-exempt status, a public charity needs to show, typically by using established mathematical tests, that it derives at least one-third of its total support from sufficiently diverse sources.

⁶⁸ Rev. Proc. 80-27, 1980-1 Cumulative Bulletin 677. Also Treas. Reg. §601.201(n)(8).

⁶⁹ Gov. Code §6500.

joint powers agreement can create a new public agency separate and apart from the agencies that formed the joint powers agency (“JPA”).⁷⁰

By agreement, the contracting or member public agencies may establish the form of the new joint powers agency. The agreement creates the JPA’s board, determines the size of the board and the structure of the board. The joint powers agreement sets forth the powers and functions of the JPA; the agreement determines the scope of the JPA’s authority and the powers the JPA will exercise. A JPA can sue and be sued; it can employ agents and employees. It can build and manage buildings and other public facilities; it can hold and dispose of property and generally do all things necessary to fulfill its purpose, all as set out in the joint powers agreement creating the JPA.⁷¹ The joint powers agreement can, and usually does, provide that the obligations of the JPA are not the obligations, debts or liabilities of the contracting or member public agencies.⁷² Because of the flexible nature of JPAs and the ease with which they can be formed, JPAs are used throughout California to facilitate public projects and services on a regional or area wide basis. In fact, most of the existing CLSA public library networks are JPAs.

Further, since JPAs are themselves public agencies, the tax and nonprofit issues surrounding creation and maintenance of nonprofit corporations do not apply to JPAs. JPAs are, however, subject to all rules governing public agencies, including but not limited to, the Open Meetings Act, the Public Records Act, public personnel regulations and the like.

With one pivotal and crucial exception, a JPA could perform all of the functions envisioned for the regional networks under the Act. The Act envisions and, indeed mandates, regional networks that include as equal members both publicly owned libraries and libraries owned and operated by nonprofit institutions and privately owned corporations and businesses.⁷³ JPAs are, however, limited to public agencies. Cities, counties, school districts, state agencies and federal agencies can join in a JPA.⁷⁴ Even public agencies from other states may join in a JPA so long as their state of origin authorizes the agreement.⁷⁵ However, there is no authority for private corporations or organizations to join JPAs as members. As recently as 1998, the California Attorney General opined that a city could not create a JPA with a nonprofit corporation. The Attorney General reached this conclusion by looking at the types of public agencies authorized to form JPAs and concluded that a nonprofit corporation, while formed for public or charitable purposes was not “‘political and governmental’ in nature.”⁷⁶

⁷⁰ Gov. Code §6503.5.

⁷¹ Gov. Code §6508.

⁷² Gov. Code §6508.1.

⁷³ Ed. Code §§18810(s); 18841.

⁷⁴ Gov. Code §6500.

⁷⁵ Gov. Code §6502.

⁷⁶ 81 Cal.Ops.Atty.Gen. 213, 215 (1998).

The Act requires that all types of libraries be eligible to join and be participating members of the regional networks, including not only publicly owned and operated libraries, but also libraries in private institutions and private corporations. Since there is no current authorization for private institutions, be they for-profit or nonprofit, to join JPAs, the JPA form of organization will not work for the regional networks.

It may be possible, however, to seek and obtain specific legislative authorization for private and nonprofit libraries to join a JPA for regional network purposes. There are examples in the Joint Exercise of Powers Act of the Legislature authorizing private nonprofit hospitals to enter into joint powers agreements with public agencies for certain specified purposes.⁷⁷ Thus, should the planning groups determine that a joint powers agency would best serve their needs, it appears to be possible to seek this specific authorization from the Legislature. For example, legislation could be proposed to implement the Act through regional network JPAs that can include as members all the types of libraries contemplated by the Act. Pursuing a legislative authorization is, however, time consuming and would likely delay full implementation of the regional networks for anywhere between six months and a year or more.

Comparison of Organizational Models; Other Models

Attached as Appendix B is a chart comparing various characteristics of a nonprofit public benefit corporation with a joint powers agency. Unincorporated associations, partnerships, limited liability companies and other forms of legal entities were also considered as possible organizational forms, but were not pursued because they lacked one or more of the major desired characteristics of a network structure, such as limited liability for the participants or the ability to be exempt from federal and state income taxation. See Appendix C for a brief description of common forms of legal entities.

⁷⁷ See, e.g., Gov. Code §§6523.5, 6523.6, 6523.7.

Timetable for Implementation

Under the Regulations, the state board will have up to 120 days from the submission of a network's plan to approve it or disapprove it.⁷⁸ If approved, network will be considered established and recognized effective on the first July 1 following state board approval.⁷⁹ If the decision is made to form a nonprofit corporation, following approval of all of the components of the plan by the state board, the network would only need to file its articles of incorporation with the Secretary of State and adopt its bylaws and certain other basic resolutions⁸⁰ in order to begin operating under the Act.

There are a number of issues related to the transition of programs and operations under the CLSA and the start-up of operations under the Act. The Act provides for a three-year establishment period during which each regional library network will receive a basic funding allocation for service delivery as it establishes services and expands its membership.⁸¹ The issues raised do not by any means need to be addressed and resolved at the outset of a network's formation. Although it may be prudent to address some of those issues earlier rather than later, the resolution of some of these issues is likely to require some time depending on a particular network's situation.

CONCLUSION

This paper has focused on the nonprofit corporation as the most viable form of organization for the regional library networks currently available under California law. Each regional network area could form a nonprofit corporation that would meet the requirements of the Act and still provide flexibility to meet regional needs and objectives. While there are a number of formalities required to form and maintain a tax-exempt, nonprofit corporation, these formalities should not impede implementation of the regional networks.

The other form of organization most likely to provide the structure and flexibility necessary to meet the objectives of the Act and the regional areas is the JPA. However, since JPAs cannot currently include nonpublic entities as members, special legislative authorization would be necessary to make JPAs a viable organizational form for the regional networks. While possible, legislative amendments, if passed, take time to be enacted and effective and would delay implementation of the Act.

⁷⁸ 5 Code of Regs. §20318(d).

⁷⁹ 5 Code of Regs. §20318(e). Pursuant to 5 Code of Regs. §20302, the state board may waive or reset any dates required by the Regulations if it would best serve the purposes of the Act and would result in more timely and effective implementation.

⁸⁰ Preliminary matters typically involve the election of the board and officers, and the selection of the place of the principal office, fiscal agent and depository for funds. In this case, planning group members could serve as the incorporators and act until the council elects its initial directors. The federal application for recognition of exemption need only be filed within 27 months of the date of the incorporation for it to relate back to the incorporation date. Treas. Reg. §301.9001-2(a)(2)(iii).

⁸¹ Ed. Code §18862.

RECOMMENDATION

Absent a decision to seek special legislative authorization permitting nonpublic entities to join a joint powers agency, the legal form of organization recommended for the regional library networks is the tax-exempt, nonprofit public benefit corporation.

Appendix A

Reporting Requirements to Governmental Agencies

The following are some of the annual reporting and filing requirements for tax-exempt, nonprofit public benefit corporations:

1. Periodic Report to the Attorney General's Registry of Charitable Trusts (Form CT-2 with copy of IRS Form 990).
2. Statement by Domestic Nonprofit Corporation to the California Secretary of State.
3. Federal information returns of tax-exempt organizations to the IRS (Forms 990, 990EZ, 990-PF), if gross receipts are \$25,000 or more.
4. California information return of tax-exempt organizations to Franchise Tax Board (Form 199), if gross receipts are \$25,000 or more.
5. Federal income tax return on unrelated business income to the IRS (Form 990-T), if applicable.
6. California income tax return on unrelated business income to the Franchise Tax Board (Form 109), if applicable.
7. Federal employment tax deposits (due dates determined by payroll amounts) and quarterly employment tax returns (Form 941) to the IRS.
8. State employment tax deposits (due dates determined by payroll amounts) and quarterly wage and withholding reports (Form DE 6) to the California Employment Development Department.
9. Annual reconciliation report of wages and withholdings (Form DE 7) to the California Employment Development Department.
10. Forms W-2 (provided to employees each year and copies filed by the employer with the federal and state governments).
11. Forms 1099 (provided to no employee service providers and copies filed with the federal and state governments).
12. Annual welfare exemption claim form for exemption from property taxes, if applicable.
13. Local and state property and sales tax statements and returns.

Notification to the IRS and the Franchise Tax Board is required if there are any changes in name, address, sources of support, purposes, character, method of operation, bylaws or articles of the organization.

An organization exempt under IRC section 501(c)(3) must keep copies of its three most recent federal tax returns, its exempt status application and determination letter available for inspection by the public at its main office and any other office with three or more employees. Copies of the returns must be provided to any person who makes a written request.

Appendix B

Comparison

	Nonprofit Public Benefit Corporation	Joint Powers Agency
Structure	At a minimum, must have a board of directors and 3 officers: a chair or president, a secretary and a chief financial officer.	Comprised of 2 or more public agencies.
Governing Documents	Articles of Incorporation and Bylaws	Joint Powers Agreement (or Joint Exercise of Powers Agreement) and Bylaws (optional).
Members and Membership	No limitation on who may become a member.	Only public agencies.
Distributions	Distributions of corporate assets (e.g., profits) to members not permitted.	Distributions to members are permitted, if allowed in the Joint Powers Agreement.
Management	Usually managed by or under the direction of the board of directors although articles and bylaws may specify actions requiring member approval. Officers manage day-to-day affairs.	Managed by a board made up of representatives of member agencies may provide for executive director and staff.
Director, Officer and Member Liability	<p>Directors and officers owe a fiduciary duty to the corporation and its members. No personal liability for alleged failure to discharge duties if they were performed in accordance with applicable standards.</p> <p>Corporation has power to indemnify directors, officers and agents of the corporation for threatened, pending or completed actions provided conduct satisfied minimum standards of care.</p> <p>Members (as such) are not liable for obligations of the corporation. Members who engage in management activity</p>	<p>Directors, officers and members are subject to all rules governing public agencies.</p> <p>Public agencies have a statutory obligations to defend and indemnify officers, directors and employees for acts or omissions within the scope of duties.</p> <p>The Joint Powers Agreement can provide that member agencies are not liable for debts of Joint Powers Agreement.</p>

	Nonprofit Public Benefit Corporation	Joint Powers Agency
	need to comply with applicable standards.	
Meetings and Voting	<p>Member meetings occur with the frequency set forth in the bylaws and at least each year in which directors are to be elected. Voting by written ballot or proxy permitted (although not permitted by the Open Meetings Act). Quorum is 1/3 of voting power represented in person or by proxy. A different quorum may be set but if less than 1/3, only those matters identified in the meeting notice may be voted upon by the members.</p> <p>Regular board meetings may be set and special meetings may be held with advance notice. A majority of the number of directors authorized constitutes a quorum although the articles or bylaws may provide for a quorum as low as 1/5 of the authorized number or 2, whichever is greater. Board members may participate by conference telephone. Action may be taken by unanimous written consent.</p>	Meetings are subject to the Open Meetings Act. A quorum is generally a majority. Voting must be done in public — no secret ballots, no voting by proxy. Board members may participate through teleconferencing.
Taxation	Corporation must receive recognition of tax-exemption from Internal Revenue Service and Franchise Tax Board to be exempt from federal income tax and California income and franchise taxes.	Tax exempt.
Dissolution	As a tax-exempt organization, assets of corporation remaining after payment of all debts and liabilities are distributed to other organizations exempt under IRC §501(c)(3).	The Joint Powers Agreement determines distribution of assets after payment of debts and liabilities. Assets may go back to member agencies.

Appendix C

Common Forms of Legal Entities

TYPE	DESCRIPTION
CORPORATION	
A. Public	An artificial person or legal entity created by the state for political purposes and to act as an agency in the administration of civil government.
B. Private	An artificial person or legal entity recognized as having an existence separate from that of its shareholders.
1. For Profit	A corporation formed to engage in any lawful act or activity for which a corporation may be organized under California General Corporation Law (other than the banking business, the trust company business or the practice of a profession) for pecuniary profit.
2. Nonprofit	A corporation formed for some charitable or benevolent purpose.
a. Public Benefit	Formed for public or charitable purposes. Though considered “not-for-profit,” a public benefit corporation may carry on a business at a profit and apply any profits from business activity to any activity in which the corporation may engage, but may not make distributions of any gains, profits or dividends to members. May be tax-exempt.
b. Mutual Benefit	Formed for other than religious, charitable, civic league or social welfare purposes. Though considered “not-for-profit,” a mutual benefit corporation may carry on a business at a profit and apply any profits from business activity to any activity in which the corporation may engage, but is limited to making distributions only on redemption of a membership or on dissolution. May be tax-exempt.
JOINT POWERS AGENCY	An entity created by two or more public agencies which have entered into an agreement to jointly exercise any power common to the public agencies involved.
SOLE PROPRIETORSHIP	A business engaged in by an individual. “Business” includes every kind of business, governmental activity, profession, occupation, calling, or operation of institutions, whether carried on for profit or not.
PARTNERSHIP	
A. General	An association of two or more persons to carry on as co-owners a business for profit. “Persons” may be individuals, partnerships, limited liability partnerships, limited partnerships, corporations, limited liability companies, and other associations.
B. Limited	A partnership with one or more limited partners and one or more general partners. General partners actively engage in the management and control of the business and have unlimited personal liability for the obligations of the partnership. Limited partners do not participate in the control of the business and are not personally liable for the obligations of the partnership.
JOINT VENTURE	An entity formed for a limited or temporary business purpose. Generally treated as a general partnership, although a limited liability company that has a limited purpose could also be called a joint venture.

TYPE	DESCRIPTION
UNINCORPORATED ASSOCIATION	Any partnership or other unincorporated organization of two or more persons, whether organized for profit or not, but does not include a government or governmental subdivision or agency. May be tax-exempt.
NONPROFIT ASSOCIATION	An unincorporated association of natural persons for religious, scientific, social, literary, educational, recreational, benevolent, or other purpose not that of pecuniary profit.
LIMITED LIABILITY COMPANY	An unincorporated business organization whose members do not have personal liability for its debts. Limited liability companies are often viewed as having the management flexibility of a partnership with the limited liability afforded shareholders of a corporation.
LIMITED LIABILITY PARTNERSHIP	Form of general partnership in which liability of partners may be limited. California currently limits the use of limited liability partnerships to attorneys and accountants.